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FISCAL IMPACT STATEMENT

LS 7896

BILL NUMBER: SB 523

NOTE PREPARED: Apr 8, 2003

BILL AMENDED: Apr 2, 2003

SUBJECT: Police and Fire Pensions

FIRST AUTHOR: Sen. Server

FIRST SPONSOR: Rep. Avery

BILL STATUS: As Passed - House

**FUNDS AFFECTED: GENERAL
 DEDICATED
 FEDERAL**

IMPACT: Local

Summary of Legislation: (Amended). This bill: (1) allows certain members of the 1977 Police Officers' and Firefighters' Pension and Disability Fund to purchase at full actuarial cost additional service credit needed for the member to retire with a full unreduced benefit. It permits the member's employer to adopt an ordinance to pay all or part of the member's contributions required for the purchase of the service; (2) provides that the pension base for a police officer or firefighter includes the part of the officer's clothing allowance that exceeds \$600.

Effective Date: July 1, 2003.

Explanation of State Expenditures:

Explanation of State Revenues:

Explanation of Local Expenditures: (Revised) *Purchase of Service Credit:* This proposal permits a member of the 1977 Police Officers' and Firefighters' Pension and Disability Fund who (1) first became a member of the Fund after December 31, 1993, and before October 1, 1996; (2) was at least 36 years old at the time the member joined the Fund; and (3) will not accrue 20 years of service prior to reaching the mandatory retirement age established by the member's employer, to purchase service credit. As drafted, this proposal affects very few members.

Only those members who need to purchase additional service in order to have a total of 20 years of service by the municipality's mandatory retirement age are eligible for this service purchase. The following formula will be used: Current 1st class salary times 27% times the amount of service to be purchased.

The cost of the service credit would be borne by the member, or by the member's employer if the member's employer adopts an ordinance to pay all or part of the member's contributions required for the purchase of the service. The cost to purchase the service will be determined by a formula. The formula includes the 27% factor, which is the combined employer and employee cost and is generated assuming all eligible members retire at the first date of unreduced retirement, typically age 52. The 27% formula would normally be expected to understate somewhat the total cost of service for members hired in their 20's. But since this bill affects those members who need 20 years of service by a municipality's mandatory retirement age, typically age 65 or higher (which means they were hired after age 45), then the cost for providing benefits for these members would be expected to be less (since benefits commence at a later age with less life expectancy). The fiscal impact on the 1977 Police Officers' and Firefighters' Pension and Disability Fund is expected to be small.

A couple of circumstances under which a member of the 1977 Police Officers' and Firefighters' Pension and Disability Fund may wish to purchase service credit and the potential impact to the fund are identified below.

(1) If a member wanted to purchase service credit, the actuary for the fund calculates the cost of that service based on the current salary, current service earned, and the member's current age. This cost represents the full actuarial cost of the service at the time of the purchase (excepting any future cost-of-living adjustments (COLAs) that may be awarded). In other words, if a member purchases the service credit on one day and then retires with benefits commencing the next day, there would be no immediate fiscal impact to the Fund. There also would be no immediate real gain to the member because the additional benefits received due to the service would be actuarially equivalent to the purchase price of the service. This changes, however, once a COLA has been awarded. Since COLAs were not included in the purchase price, such a COLA would represent a real gain to the member and a fiscal impact to the Fund.

(2) If the member purchases service credit and continues employment, the member may also be able to benefit from the earlier purchase of service credit for a second reason. As the member continues employment, the member can expect increases in salary. These salary increases will increase the benefit the member can expect to receive at retirement. However, the purchase price of the service was based on the member's salary **at the time of purchase** before any increases in salary. Any increase in the value of the member's benefit because of salary increases was not included in the purchase price, therefore representing a real gain to the member and an impact to the fund.

\$600 Clothing Allowance: The fiscal impact of including in the pension base that part of an officer's clothing allowance that exceeds \$600 is dependent on the increase which would occur in the pension base of first class salaries. The average clothing allowance overage on a statewide basis amounted to \$249. Based on available data from 1st, 2nd, and 3rd Class cities, it is estimated that the salary base may increase, on average, by \$249 due to clothing allowances in excess of \$600. (This assumes a salary base increase, for example, from \$35,500 to \$35,749 annually.) The fiscal impact of this change would be as follows:

	1925, 1937, 1953 Funds	Converted 1977 Plan	Non-Converted 1977 Plan
Increase in Actuarial Liabilities	\$14.96 M	\$2.19 M	\$4.46 M
Increase in Annual Funding	\$0.76 M	\$93,963	21% of payroll (would increase to 22.45%)
Approximate # Members Affected	11,232	891	12,123

The above costs are to the local units who have members in the funds affected. Pension benefits for police and firefighters are equivalent to 50% of the salary of a first class officer, as defined by each individual city. Cities and towns with members in the affected funds appropriate money from police and fire pension funds. The sources of these funds are property taxes, Motor Vehicle Excise Taxes, and Financial Institutions Taxes.

Explanation of Local Revenues:

State Agencies Affected: Public Employees' Retirement Fund as administrators of the 1977 Police Officers' and Firefighters' Pension and Disability Fund.

Local Agencies Affected: Cities and Towns with members in the specific funds, and those units with members who qualify under the conditions set forth in the proposal.

Information Sources: Doug Todd, of McCready and Keene, Inc., actuaries for the police and fire funds, 576-1508.

Fiscal Analyst: James Sperlik, 317-232-9866.

Additional Information/Definitions:

Actuarial Equivalent: If the present value of two series of payments is equal, taking into account a given interest rate and mortality according to a given table, the two services are said to be actuarially equivalent. For example, under a given set of actuarial assumptions, a lifetime mortality benefit of \$67.60 beginning at age 60 can be said to be the actuarial equivalent of \$100 a month beginning at age 65. The actual benefit amounts are different but the present value of the two benefits, considering mortality and interest, is the same.

Actuarial Liability: The excess of the present value of all benefits thereafter payable under the system over the present value of future normal costs.

Consumer Price Index: The consumer price index is the name given in both the United States and Canada to the series of numbers whose ratios measure the relative prices at various times of a selected group of goods and services which typify those bought by urban families.

Converted: Members hired before May 1, 1977, who have elected to convert to the benefit structure under the 1977 Act.

Cost of Living Adjustment: An across-the-board increase (or decrease) in wages or pension benefits according to the rise (or fall) in the cost of living as measured by some index, often the Consumer Price Index (CPI).

Funding: A systematic program under which assets are set aside in amounts and at times approximately coincident with the accruing of benefit rights under a retirement system.

Non-Converted 1977 Plan: Members hired after April 30, 1977, all of whom are covered by the benefit structure under the 1977 Act.

Old Plan: Members hired before May 1, 1977, who have not elected to convert to the benefit structure under the 1977 Act.